United States Court of Appeals

for the Second Circuit

APPELLEE'S BRIEF

ORIGINAL

To be Argued By
Herbert Dicker

UNITED STATES COURT OF APPEALS
FOR THE SECOND CIRCUIT

75-7157

MARVIN STONE,

Plaintiff-Appellant

-against-

UNDERWRITERS AT LLOYD'S LONDON,
NORTH STAR REINSURANCE CORP.,
and FIRST STATE INSURANCE COMPANY,

Defendants-Appellees

BRIEF SUBMITTED ON BEHALF OF
DEFENDANTS-APPELLEES

KROLL, EDELMAN, ELSER & WILSON
Attorneys for Defendants-
Appellees
Office & Post Office Address
22 East 40th Street
New York, New York 10016
Telephone: (212) 686-2686

Herbert Dicker
Brian A. Sheridan
Of Counsel

Appeal Reproductions Inc., 217 Broadway, New York, N.Y. 10007
Tel: 233-6626

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BRIEF FOR APPELLEES

NATURE OF ACTION

This is an action by plaintiff, a non-resident alien, against ROBERT C. SELLS, as Lead Underwriter subscribing to a Professional Indemnity Insurance Policy (hereinafter referred to as "SELLS") and two other insurance carriers, to wit, NORTH STAR REINSURANCE CORP. and FIRST STATE INSURANCE COMPANY (hereinafter referred to as "NORTH STAR" and "FIRST STATE", respectively). Damages are sought in the sum of $1,300,000. The defendants issued assayer's professional indemnity policies to O'Malley with combined limits for assayer's errors and omissions claims up to $2,000,000. The

insurance policy of SELLS, No. 91861, was to be effective from January 31, 1972 to January 31, 1973, with limits of $250,000. for assayer's errors and omissions claims (Appendix, p.22A, et. seq.); NORTH STAR'S excess reinsurance policy No. NSX-10186 was effective from February 4, 1972 to January 31, 1973 and afforded coverage for assayer's errors and omissions in the sum of $750,000. each claim in excess of the underlying coverage of $250,000. (Appendix, p. 22A, et.seq.); FIRST STATE'S Policy No. 900427 was to be effective from February 7, 1972 to January 31, 1973 and afforded coverage for assayer's errors and omissions in the sum of $1,000,000. each claim in excess of the underlying coverages of $1,000,000. (Appendix, p.22A, et. seq.).

Prior to the commencement of this action and on or about February 20, 1973, the defendants sent written notice to O'Malley, disclaiming any coverage to him under the aforementioned insurance policies (Appendix, p.2A). The disclaimer to O'Malley was based upon the latter's breach of the aforementioned insurance contracts, material misrepresentations contained in his application for insurance, breach of warranty and upon certain other exclusionary provisions contained in said policies (Appendix, p. 19A).

The Complaint alleges that in reliance upon certain representations of O'Malley, and upon the fact that

the defendants had issued professional indemnity policies for assayer's errors and omissions to O'Malley, the plaintiff for a consideration of $700,000. purchased 53 metal bars allegedly containing precious metals (Par. 7, Complaint; Appendix, p.5A); that on or about October 11, 1972, plaintiff learned that the metal bars were worthless (Par. 9, Complaint; Appendix, p.6A). The plaintiff advances the theory that the defendants "knew or should have known that plaintiff would rely upon the fact that each of said defendants had issued unto O'Malley, the aforementioned said policies of insurance....and the plaintiff would rely upon the purported reputation and standing of O'Malley as a reputable and qualified assayer, as evidenced by the fact that said defendants...had insured O'Malley against assayer's errors and omissions....." (Par. 10, Complaint; Appendix, p.6A). The answers of each of the defendants assert as an affirmative defense, that the the Complaint fails to state a claim upon which relief can be granted (Appendix, pp.9A, 12A, 14A).

Significantly, plaintiff previously commenced a separate action against O'Malley in the United States District Court, Southern Distfict of New York (STONE V. O'MALLEY, 72 CIV. 4757)(Appendix, p.18A - 19A). The latter action was transferred to the United States District Court,

Denver, Colorado by order of the Hon. Constance Baker Motley, dated May 7, 1973, following O'Malley's motion to dismiss the complaint for lack of jurisdiction. The action against O'Malley by Stone in Colorado is still pending and has not been reduced to judgment (Appendix, p.19A).

PRELIMINARY STATEMENT

The preliminary sections of the appellant's brief are generally accepted by the appellees as a statement of the nature of the action, the contents of the pleadings, and facts relative to the motion below which resulted in the dismissal of the appellant's complaint. There are, however, certain assertions of facts made by the appellant under caption of "The Facts" and which do not appear in the motion papers submitted to the Court below.

The first such fact is the assertion that the "general agent" of the appellees, R. B. Jones, Inc., "apparently investigated O'Malley's qualifications and bona fides before issuing these policies" (Appellant's brief, p.12). The sole basis for this supposition appears to be that a letter from the appellees' assured, John B. O'Malley, Jr., was received by R. B. Jones, Inc. and probably read. The fact that an investigation was or was not made by R. B. Jones, Inc. is not a matter of record in this action, and

should be excluded from this Court's consideration.

The second fact not appearing in the record, and which should not be considered on the appeal, is that "the defendants' general agent knew that plaintiff was so relying" upon the fact of issuance of insurance policies as evidence of the appellees' assured's qualifications. The allegation in the Complaint is that the appellees knew or should have known that the appellant would rely upon such fact (Complaint, Par. 10; Appendix, p.6A).

The final allegation of fact made here for the first time is that prior to entering into the purchase of platinum, the appellant "was in detailed communication" with the purported general agent of the appellees regarding the assured of the latter (Appellant's brief, p.12).

The Complaint nowhere asserts that any explicit representation was made by any of the appellees, nor by anyone acting on their behalf, regarding qualifications of the appellees' assured; instead, the appellant asserted in his Complaint that the so-called representations were implicit and based solely upon the occurrence of facts consisting of the issuance of insurance policies and certificates of insurance.

ISSUES ON APPEAL

In the District Court, the defendants' moving

argument urged that the complaint, in effect, asserted a direct action against the insurer of a third-party, and was based in contract. It was there argued that such an action was in derogation of the common law, and could be maintained only if the appellant first showed compliance with statutory prerequisites contained in Section 167 of the New York State Insurance Law which permits such direct actions under certain circumstances which the appellant conceded were not present here.

In his opposition papers, the appellant denied the vitality of the direct action argument, repudiated any claim to an action in contract, and instead asserted that his action was based upon "negligent misrepresentation", or some other tort falling within that vague panorama.

Since the appellant in his brief unequivocally denies that his action is direct and grounded in contract, this Court is then faced with a complaint said to assert "negligence or negligent misrepresentation".

The record shows that the appellees are insurers whose business consists of the underwriting of sundry risks for which a premium is paid by the assured (Complaint, Pars. 3, 4, 5,; Appendix, pp.3A, 4A). It is implicitly alleged in the complaint, and probably generally true, that the appellees, like other insurers, do to some

extent investigate prospective risks with a view towards assembling some facts to which an application of underwriting guides will be made. However, it is to be emphasized that the appellees are not, and are not alleged to be, in the business of making investigations.

Another significant consideration is that the appellant has not alleged in his complaint that the conclusions of the appellees' alleged investigation were communicated to him, let alone, the full basis upon which the alleged investigatory analysis was grounded.

Instead, this Court must determine if it wishes to extend the law so as to make actionable a wholly implicit representation said to have been made solely by reason of the occurrence of a fact, and made by persons not in the business of making such representations to anyone other than themselves for internal considerations.

POINT I

NO ACTIONABLE CLAIM FOR NEGLIGENCE OR "NEGLIGENT MISREPRESENTATION" IS PRESENTED BY THE APPELLANT

The appellant's argument on appeal begins with a discussion of the treatment to be rendered by a District Court Judge in connection with a motion for accelerated disposition. The authorities cited stand for general propositions which appear to have been appropriately applied by the lower Court as more fully appears from the substantive argument of the appellees set forth below.

On this appeal, plaintiff relies on certain authorities said to make actionable "negligent misrepresentation". While the authorities so cited embrace the rule suggested by the appellant, a reading of these authorities shows that each, by language of limitation, forcloses the possibility that the instant action may be maintained.

Setting aside for the moment the citations to a legal treatise (Prosser, Torts) and a journal article [Hill, Damages for Innocent Misrepresentation, 73 Col. Law Review, 679 (1973)], this brief will first deal with the New York State cases upon which the appellant relies.

The first case, both chronologically by date and in order of appearance in the appellant's brief, is Glanzer

v. Shepard, 233 N.Y. 236 (1922). That case involved an action by a vendee plaintiff against defendant public weighers who had certified for the plaintiff's vendor the weight of beans purchased by that plaintiff. In order to appreciate the rule of law then enunciated, it is necessary to set forth the additional fact found by that Court that the defendants had been engaged by the vendor to make the weighing in order to induce the consummation of the contract, and that this fact was known to the weighers. This is to be found at 233 N.Y. 236, 238, where the text recites:

> "The plaintiffs' use of the certificates was not an indirect or collateral consequence of the action of the weighers. It was a consequence which to the weighers' knowledge, was the end and aim of the transaction. (The vendor) ordered, but (the plaintiffs) were to use. The defendants held themselves out to the public as skilled and careful in their calling. They knew that the beans had been sold, and that on the faith of their certificate payment would be made. They sent a copy to the plaintiffs for the very purpose of inducing action. All this they admit. In such circumstances, assumption of the task of weighing was the assumption of a duty to weigh carefully for the benefit of all whose conduct was to be governed".

The Glanzer case implicitly established the touchstones to which the Court of Appeals followed in the subsequent cases of Ultramares Corp. v. Touche, 255 N.Y. 170 (1931) and State Street Trust Company v. Ernst, 278 N.Y. 104

(1938), which complete the catalogue of New York State cases cited by the appellant in defense of the claim pleaded.

Ultramares, supra, involved auditors who certified a balance sheet with knowledge that it would be exhibited to various prospective creditors of a company which went bankrupt within a year following certification. The auditors had failed to verify, among other things, that a ledger entry of over $300,000 in purported accounts receivable was supported by entries to the audited company's journal. The plaintiff, which had advanced funds to the audited company on the basis of the certificate, instituted an action in negligence and fraud against the auditors. The first cause of action there asserted was said by Mr. Justice Cardozo to be "misrepresentations that were merely negligent"; the second cause of action was said to be "for misrepresentations charged to have been fraudulent".

In sustaining a dismissal of the cause of action for negligent misrepresentation, the Court was cautious in refraining from extending the bounds for such recovery far beyond those circumstances which would permit recovery for fraud. Of this, Chief Judge Cardozo wrote at page 187:

> "We have said that the duty to refrain from negligent representation would become coincident or nearly so with the duty to refrain from fraud if this action could be maintained. A representation, even though knowingly false, does not constitute ground

> for an action of deceit unless made with the intent to be communicated to the persons or class of persons who act upon it to their prejudice....Cases of fraud between persons so circumstanced are, however, too infrequent and exceptional to make the radii greatly different if the fields of liability for negligence and deceit be figured as concentric circles."

In the course of its ruling, the Ultramares court considered the suggestion by the plaintiff there that a recovery could be had for negligence since, first, the duty to speak with care arises when the words are the culmination of a service, and secondly, the duty arises only when the service is rendered in the pursuit of an independent calling, characterized as public. The Court rejected the suggested limitation and established a greater stricture by observing that in a relation imposing a duty of diligence, speech as well as conduct must meet the duty, and that a public accountant is public only to the extent that auditing, etc., services are offered to those who wish to engage the accountants for that purpose.

In Ultramares, supra, the Court was cautious in limiting liabilities, for it stated that accountants would be held liable, as in the cause of action for fraud, if there had been a reckless misstatement or insincere profession of an opinion by the accountant.

In citing examples of liabilities not to be embraced

by the common law, the Court gave an example suitable to the instant case and certainly damaging to the claimant's claim. At page 188, Mr. Justice Cardozo wrote:

> "Liability for negligence if adjudged in this case will extend to many callings other than an auditor's....Title companies insuring titles to a tract of land, with knowledge that at an approaching auction the fact that they have insured will be stated to the bidders, will become liable to purchasers who may wish the benefit of a policy without payment of a premium. These illustrations may seem to be extreme, but they go little, if any, farther than we are invited to go now. Negligence, moreover, will have one standard when viewed in relation to the employer, and another and at times a stricter standard when viewed in relation to the public."

The illustration of the action against a title company is at best nominally different from that which is alleged in the instant action. In both events, the plaintiff would have to contend that it relied upon the fact that an investigation of the risk was made by the insurer. The plaintiff has suggested no reason why this Court should read Ultramares and still refuse to accept Mr. Justice Cardozo's characterization of an analogous or identical claim as extreme.

State Street Trust Company, supra, also involved public accountants who had certified the balance sheet of a company for purposes of a credit transaction whereby the plaintiff would advance money to the company whose records

were certified. The State Street Trust Company case reiterated the rule stated in Ultramares, supra, that liability would be imposed upon public accountants who had made a reckless misstatement, an opinion of such fragile basis as to suggest the likelihood of no basis, or a certification stated as upon the knowledge of the accountants who in fact had no knowledge. The Court retained previous restrictions on recovery to instances of fraud, feeling the aforementioned delicts sufficient to raise the inference of fraud.

In all of the New York State cases cited by the appellant, there are two crucial and recurring elements lacking in the case at bar. The first of these is that the defendants in the cited authorities have each principally engaged in the activity of which the failure to properly perform was the basis of imposition of liability. In the instant case,, the defendants-appellees are insurers whose principal business is the underwriting of various risks submitted to them by prospective insureds. Investigation of these risks is only collateral to the business of underwriting yet necessary for intelligent conduct of the appellees' affairs. Were the appellees' private investigators retained by the appellant, or by O'Malley for purposes

of exhibiting the contents of such an investigation to the appellant for purposes of inducing the appellant to deal with O'Malley, the plaintiff would arguably possess an actionable claim. The fact that the appellees do not have this status requires that the District Court's ruling be affirmed.

The second recurring element is that the causes of action sustained by the New York Courts were based upon allegation and proof of facts sufficient to form an inference of fraud. Since such allegations are not here made, the plaintiff is foreclosed from proving that which is necessary to lend vitality to his claim.

The remaining cases cited by the appellant similarly are based on allegations not here made. Jones v. United States, 207 F.2d 563 (2 Cir. 1953), involved an action against the United States based on a survey alleged to have been improperly made by the United States Geological Survey. Although the decision in Jones is restricted to application of the Federal Tort Claims Act, the fact that the survey was made by the United States Geological Survey as a principal and public function of that agency would be sufficient to distinguish that case from the instant case even if a substantive opinion had been rendered. A similar application of the Federal Tort Claims Act was made in Hall v. United States, 274 F.2d 69 (10 Cir. 1959). Hall,

supra, involved a Department of Agriculture livestock test showing that the plaintiff's cattle were diseased when in fact they were not. This again involved a claim seeking to impose liability against a defendant on the basis of a principal and public function of the latter.

Stein v. Treger, 182 F.2d 696 (D.C. Cir. 1950), sought to recover on the basis of misrepresentation as to the availability and the delivery schedule of whiskey through a Chicago based company later found unable to make timely deliveries. That Court adhered to the requirement that representations present at least the inference of fraud.

Isen v. Calvert Corp., 379 F.2d 126 (D.C. Cir. 1967), involved the sale of 12,500 square feet of real property of which only 10,000 feet was commercially zoned and the remaining 2,500 feet designated as special use property. The plaintiff sought to recover for damages based upon his inability to use the 2,500 feet. The applicability of this case to the instant action is elusive since the precise theory of law sought to be utilized by the plaintiff is not stated; the best indication is that the action was based upon traditional misrepresentation by a vendor, and hence is of no bearing on the instant case.

The last case cited by the appellant in support of his substantive argument is United States v. Neustadt,

366 U.S. 696 (1961). There, the FHA had appraised property, which had certain hidden defects, rendering the fair market value of the property substantially less than that appraised. The basis for the lower Court's determination to hold the government liable was that the latter had breached a duty imposed upon it by statute. The Supreme Court refrained from considering that argument, and simply held the claim barred by the Federal Tort Claims Act. Had a substantive opinion been rendered in favor of the plaintiff in that action, it would have no bearing on the instant case which does not seek to impose liability on the basis of a statutory duty.

In Derry v. Peek, 14 A.C. 337 (1889), cited by appellant, the Court held that actual fraud must be proved in order for recovery. The article by Hill, supra, concludes that a non-promissory innocent misrepresentation of fact, as here alleged, should not be the basis of liability. The generalized citation to a number of pages of the treatise by Prosser is at best indicative of the lack of guidance the appellant offers to this Court.

Each of the cases cited by the appellant concerned representations which were made either orally or in writing. In this case, the appellant's claim is asserted to be implicit and based upon the occurrence of the fact of the

issuance of insurance policies and certificates of insurance. The Complaint is devoid of any allegation that the appellees implicitly made any representations whatsoever as to the qualifications of O'Malley to perform the services for which he was engaged by the appellant. Imposition of liability in this case would be revolutionary to the law as well as to the insurance industry which would be exposed to claims by paristic individuals described by Chief Justice Cardozo in Ultramares, supra, as desiring the benefit of the policy without payment of the premium; the Court in Ultramares characterized an action of this nature as extreme.

Neither advancement of the law nor current, nor prospective public policy suggests any result other than affirmance of the District Court's ruling.

POINT II

NO DIRECT ACTION ON THE POLICY LIES AS AGAINST THE APPELLEES

Although the appellant denies that his action is a direct action against the appellees on the basis of alleged contractual obligations of the latter, the instant point is relevant to a determination of whether the appellant does or can state a claim upon which relief may be granted.

As a general rule, there is no privity between an injured person and a liability insurer and the former has no right of action at law against the latter, Burke v. London Guaranty & Acc. Co., 199 N.Y. 557. By statute in New York, an injured person who has recovered judgment may, in accordance with the terms of the statute, bring an action against the judgment debtor's liability insurer, Sections 167 subd. 1(b), 167, subd. 7, Insurance Law, State of New York.

These sections superseded former Section 109 of the Insurance Law, prior to which no direct action was maintainable against an insurer by a third-party allegedly injured by an insured. Subd.7 of Section 167 provides that:

"7. Subject to the limitations and conditions of subsection one, Paragraph (b), an action may be maintained by the following persons against the insurer upon any policy or contract of liability insurance which is governed by said Paragraph (b), to recover the amount of the judgment against the insured or his personal representative.

(a) Any person who...has obtained a judgment against the insured..., for damages for injury sustained or loss or damage occasioned during the life of the policy...."

Prior to the enactment of the above statute, an injured person possessed no cause of action against the insurer of a tortfeasor because of the lack of privity of contract, Jackson v. Citizens Cas. Co., 277 N.Y. 385; McNamara v. Allstate Insurance Co., Chicago, Ill., 3 A.D. 2d 295.

However, being in derogation of the Common Law, the statute must be strictly construed, Jackson v. Citizens Cas. Co., supra; McNamara v. Allstate, supra; Lawyers Indemnity Co. v. Travelers Insurance Co., 244 A.D. 582, aff'd 270 N.Y. 574. In order to take advantage of the statutory provisions which entitle one to proceed against an insurer, the injured party must fully comply with the conditions precedent prescribed thereby, Warner v. Nationwide Insurance Co., 16 Misc.2d 204; Lang v. Merchants Mut. Cas. Co., 203 Misc. 258.

Section 167 of the Insurance Law does not authorize a direct action by an injured person against the insurer of the person liable for the injury until the claim has been reduced to judgment; the action against the insured is a necessary legal preliminary to the action by the injured person against the insurer. Matelsky v. Globe Indemnity Co., 161 Misc. 163. The action which is brought is predicated upon the statute and not upon the contract of insurance. McNamara v. Allstate, supra.

By virtue of Section 167, Insurance Law, four conditions must be met before an insurer may be sued:

> "(1) Judgment against the insured, which
>
> (2) remains unsatisfied at the end of thirty days from
>
> (3) service of notice of entry of judgment upon the insured and upon the insurer, and
>
> (4) the absence of any stay of execution against the insured; McNamara v. Allstate, supra."

Accordingly, until notice of entry of the judgment is served both upon the insured and upon the insurer, and until the judgment thereafter remains unsatisfied for thirty days, the injured person cannot maintain an action against the insurer. Lang v. Merchants, supra.

To the extent that the complaint may be said to assert a direct action against insurers arising out of

alleged wrongful acts of the latters' insured, it is prohibited under New York law.

The rule is also well-settled that a judgment creditor seeking to enforce a policy insuring the judgment debtor against liability, stands in the shoes of the insured and has no greater rights against the insurer than those of the insured. Sperling v. American Indemnity Co., 7 N.Y.2d 442; Hartford v. Breen, 2 A.D.2d 271. Such person may not recover against the liability insurer unless the insured could have recovered had he paid the judgment and sued the company. Wenig v. Glen Falls Indemnity Co., 294 N.Y. 195.

The statute which gives an injured person, after judgment, the right to proceed against the insurer upon the policy, has been held not to increase the rights of the injured person over those of the insured. Devitt v. Continental Cas. Co., 269 N.Y. 474. In the present situation, there has been no judicial determination of the obligations between O'Malley and the appellees with regard to their respective rights and obligations under the errors and omissions liability policies. (Appendix, p.18A) There has been a written disclaimer sent in behalf of the defendants to and received by O'Malley; in the Colorado litigation between Stone and O'Malley, the latter has retained his own attorneys to defend the action (Appendix, p.19A).

Absent allegation of fulfillment of the statutory prerequisites, the complaint fails to state a claim.

Other states arguably connected with the facts surrounding the instant action likewise permit "direct actions" if at all, under conditions identical or similar to New York:

1. Colorado: Jorgensen v. St. Paul Fire And Marine Insurance Co., 158 Colo. 466, 408 P.2d 66; Overturf v. National Union Fire Insurance Co., 470 P.2d 600; Colorado does not permit any direct action at all, and requires the injured party to secure judgment against the insured and then proceed by way of garnishment against the insurer.

2. Missouri: V.A.M.S. §379.200. Direct action under conditions similar to the New York rule.

3. Illinois: Illinois Insurance Code. Rev. Stat. Ch. 73, §1000. Permits direct action under circumstances similar to the New York requirement.

Thus, even the other jurisdictions whose laws could possibly be applied would not permit the maintenance of the appellant's action as a "direct action".

CONCLUSION

THE RULING OF THE DISTRICT COURT DISMISSING THE COMPLAINT SHOULD BE AFFIRMED.

Respectfully submitted,

KROLL, EDELMAN, ELSER & WILSON
Attorneys for Appellees
Office & P.O. Address
22 East 40th Street
New York, New York 10016

Of Counsel:

Herbert Dicker, Esq.
Brian A. Sheridan, Esq.

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Appellee's Brief

IS HEREBY ADMITTED.

DATED: Oct. 6, 1975

Friedmann, Fischman & Chikofsky

Attorneys for Plaintiff